



Legislative Audit Division

State of Montana

Report to the Legislature

December 2002

Financial-Compliance Audit For the Two Fiscal Years Ended June 30, 2002

Department of Revenue

This report contains eight recommendations to the department. Major issues addressed in the report include:

- **Administration of wage base taxes.**
- **Management controls over travel advances.**
- **Compliance with state laws and regulations.**

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FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2003, will be issued by March 31, 2004. The Single Audit Report for the two fiscal years ended June 30, 2001, was issued on March 26, 2002. Copies of the Single Audit Report, when available, can be obtained by contacting:

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December 2002

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the Department of Revenue for the two fiscal years ending June 30, 2002. We issued a qualified opinion on the financial schedules of the department. Included in this report are eight recommendations to the department. The department's response is located beginning on page B-3.

We thank the director and staff for their assistance and cooperation throughout the audit.

Respectfully submitted,

(Signature on File)

Scott A. Seacat
Legislative Auditor

Legislative Audit Division

Financial-Compliance Audit

For the Two Fiscal Years Ended June 30, 2002

Department of Revenue

Members of the audit staff involved in this audit were Laurie Barrett, Jeane Carstensen-Garrett, Hollie Koehler, Angie Lang, Emlyn Neuman-Javornik, Laura L. Norris, Alexa O'Dell, and Joyce Weber.

Table of Contents

Appointed and Administrative Officials	iii
Report Summary	S-1
Introduction.....	1
Introduction	1
Department Organization and Functions	1
New Legislation	3
Total Revenue	4
Prior Audit Recommendations.....	5
Prior Audit Recommendations	5
UI Prior Audit Recommendations	5
UI Deposits	5
UI Billing	5
UI Refunds	6
Summary	6
Federal Reporting	6
Penalty and Interest	7
Findings and Recommendations	9
Wage Base Tax Issues.....	9
System to Identify, Bill and Collect from Employers	9
Financial Activity	11
System to Calculate and Adjust UI Contribution Tax Rates	11
Management Controls Over Travel Advances.....	13
Liquor Receivables	15
Noncompliance With State Laws	16
Timely Deposits	16
Automatic Extensions	16
Rules for Tax Credits	17
Residential Property Tax Credit	17
Coal Tax Bond Fund	17
County Collections	17
Independent Auditor's Report & Department Financial Schedules	A-1
Independent Auditor's Report.....	A-3
Schedule of Changes in Fund Balances & Property Held in Trust for the Fiscal Year Ended June 30, 2002	A-5
Schedule of Changes in Fund Balances & Property Held in Trust for the Fiscal Year Ended June 30, 2001	A-6
Schedule of Total Revenues & Transfers-In For the Fiscal Year Ended June 30, 2002.....	A-7

Table of Contents

Schedule of Total Revenues & Transfers-In For the Fiscal Year Ended June 30, 2001.....	A-8
Schedule of Total Expenditures & Transfers-Out For the Fiscal Year Ended June 30, 2002.....	A-9
Schedule of Total Expenditures & Transfers-Out For the Fiscal Year Ended June 30, 2001.....	A-10
Notes to the Financial Schedules.....	A-11
Department Response.....	B-1
Department of Revenue.....	B-3

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Department of Revenue

This report documents the issues noted during our financial compliance audit of the Department of Revenue for the two fiscal years ended June 30, 2002. The previous audit report contained eight recommendations. The department implemented two of the recommendations, partially implemented five, and one recommendation is no longer applicable to the department. This report contains eight recommendations directed to the department.

We issued a qualified opinion on the financial schedules presented in this report. This means the reader should use caution when relying on the presented financial information and the supporting detailed information on the primary accounting records.

The listing below serves as a means of summarizing the recommendations contained in the report, the department's response thereto, and a reference to the supporting comments.

Recommendation #1

We recommend the department comply with UI tax reporting requirement contained in its contract with DOLI.7

Department Response: Concur. See page B-3.

Recommendation #2

We recommend the department determine and record the adjustments necessary to properly reflect penalty and interest activity on the accounting records.....8

Department Response: Concur. See page B-3.

Recommendation #3

We recommend the department:

- A. Obtain timely reports that identify employers who have not fully paid UI or withholding taxes.
- B. Actively monitor and bill employers who have not fully paid wage base taxes due.

Report Summary

- C. Correct data errors, correct POINTS defects, and provide additional training to personnel.
- D. Determine and record on the accounting records taxes owed to the department which have not yet been received. 11

Department Response: Concur. See page B-3.

Recommendation #4

We recommend the department:

- A. Accurately calculate UI rates as required by state law.
- B. Establish controls over UI rate inquiries and adjustments. 13

Department Response: Concur. See page B-4.

Recommendation #5

We recommend the department establish management controls to ensure permanent travel advances are reasonable and necessary. 15

Department Response: Concur. See page B-5.

Recommendation #6

We recommend the department take necessary action so the terms for payment from agency stores are the same terms as the state's payment to the vendors..... 16

Department Response: Partially Concur. See page B-5.

Recommendation #7

We recommend the department:

- A. Comply with the state laws noted above.
- B. If necessary, seek legislation to amend the laws..... 17

Department Response: Concur. See page B-6.

Recommendation #8

We recommend the department:

- A. Establish procedures to ensure counties submit collection reports in a timely manner as required by law.
- B. Ensure accrual calculations are correct prior to recording them on the state's accounting system. 18

Department Response: Concur. See page B-6.

Introduction

Introduction

We performed a financial-compliance audit of the Department of Revenue (department) for the two fiscal years ended June 30, 2002. The objectives of our audit were to:

1. Determine if the department complied with applicable state and federal laws and regulations.
2. Obtain an understanding of and, if appropriate, make recommendations for improvement in the internal and management controls of the department.
3. Determine the implementation status of prior audit recommendations.
4. Determine if the department's financial schedules present fairly the results of its operations for each of the two fiscal years ended June 30, 2002.

In accordance with section 5-13-307, MCA, we analyzed and disclosed the costs, if significant, of implementing recommendations contained in this report. Issues deemed not to have significant effect on department operations have been discussed with management but are not included in this report.

As required by section 17-8-101(6), MCA, we analyzed the rates charged and fund equity of the department's Internal Service Fund. We found the rates were commensurate with costs for the activity in the Internal Service Fund in fiscal year 2001-02.

Department Organization and Functions

The Department of Revenue (DOR) collects revenue from and enforces regulations for over 30 state taxes and fees. Taxes collected include income, corporation, natural resource, accommodation, unemployment insurance, and inheritance. The department also regulates the sale and distribution of alcoholic beverages in the state. The department is organized into the following five core processes with overall agency direction and management coordinated from the Director's Office.

Introduction

The Director's Office (39.5 FTE) provides management control, policy direction, strategic planning, and legal services to assist the tax and liquor programs in fulfilling their responsibilities. Legal Services advises all agency programs and handles tax appeals before the State Tax Appeal Board and state courts. The Director's Office also includes the Policy and Performance Management Unit, the Office of Dispute Resolution, and the Tax Policy and Research Unit.

The Policy and Performance Management Unit supports the department's core processes and is responsible for coordinating the strategic development of operating policies, budgets, rules, performance management, change management, and strategic planning for the department.

The Office of Dispute Resolution performs the department's dispute resolution efforts, including informal tax appeals, in a single location and process.

The Tax Policy and Research (TPR) Unit is responsible for estimating state revenues, coordinating department legislation and fiscal notes, reviewing all legislation related to revenue, and conducting revenue-related research.

The Information Technology Program (37.25 FTE) is responsible for planning, coordinating, delivering, and controlling information resources for the department. The program is responsible for managing all computing services provided to the department, including integrating and managing desktop, mid-tier, and mainframe applications as well as network support services. This also includes the implementation and maintenance of the Process Oriented Integrated System (POINTS). POINTS is designed to provide integrated information concerning the department's customers. The system provides information relating to registration, accounting, processing, correspondence, case management, and forms.

The Resource Management Program (42 FTE) provides services and support to the department by integrating the human resources, accounting, facilities management, communications, and training and

education functions of the department. The Liquor Distribution Unit is managed in this program.

The Customer Service Center (CSC) (127.20 FTE) combines the customer intake, document and information processing, and the accounts receivable and collections functions into a single business unit designed to provide centralized and consistent customer service, data and information processing, and accounts receivable collections for the department.

The customer intake function represents the initial contact point for customers. The document and information processing function provides data capture, remittance processing, records management, direct deposit of cash receipts and revenue, and mail processing and distribution. The accounts receivable and collections function provide a point of contact for debtors and is responsible for delinquent account collection and enforcement activities.

The Compliance, Valuation, and Resolution (CVR) (418.78 FTE) staff performs audits and a variety of other measures including disputes and appeals in order to verify taxpaying entities are in compliance with the law. Some of the taxes administered by the program include individual income, corporation, natural resource, accommodation, and unemployment insurance. CVR also establishes property valuation of properties statewide with three district offices representing geographic areas of the state. Additionally, there are eight regional offices and offices in all counties in order to provide timely and quality customer service to the taxpaying public.

New Legislation

Chapter 574, Laws of 2001, (House Bill 124) revised local government funding laws. House Bill 124 changed where revenues from fees and taxes collected by the counties are to be deposited. For the most part, these revenues are to be deposited in the state General Fund. Impacts on counties are offset by entitlement payments made from the state General Fund. The TPR unit completed calculating and helping local government implement the

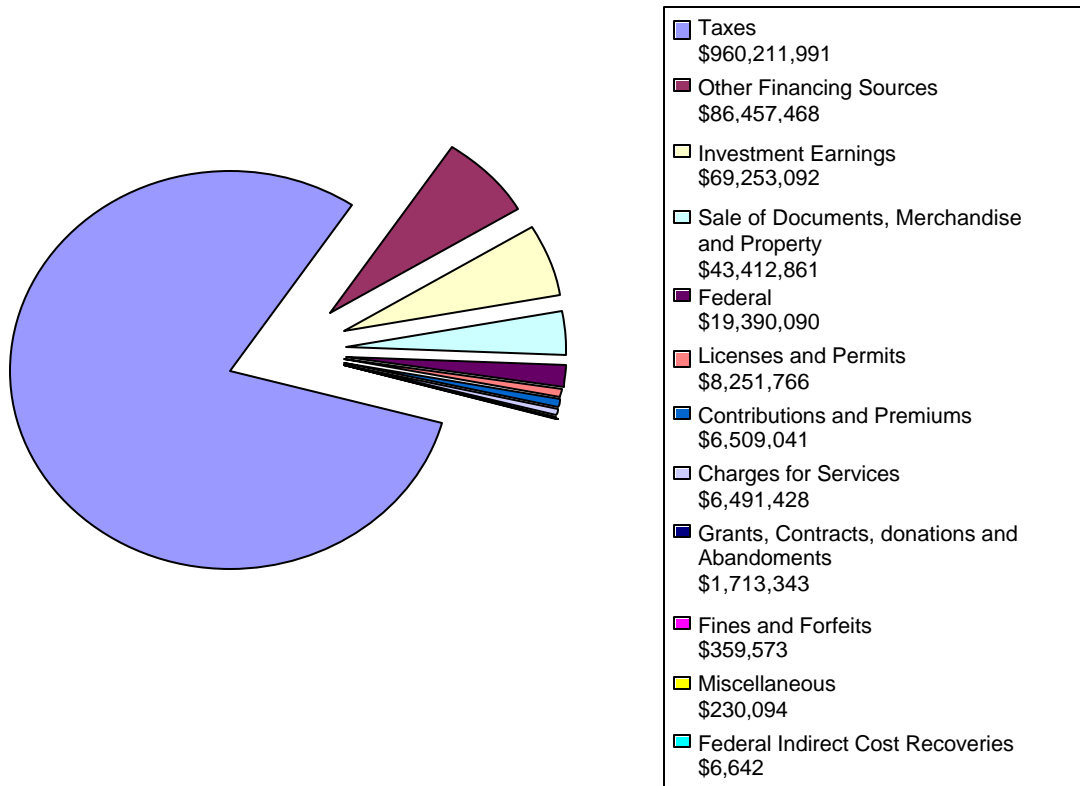
Introduction

HB 124 Entitlement Share Payment. The department distributes quarterly entitlement share payments to Montana's county and local governments statewide.

Total Revenue

Total revenue by class, as recorded by the department, is identified below for fiscal year ended June 30, 2002.

Figure 1
Total Revenue by Class



Source: Compiled by the Legislative Auditor's office from the financial schedules.

Prior Audit Recommendations

Prior Audit Recommendations

The financial-compliance audit report of the department for the two fiscal years ended June 30, 2000, contained eight recommendations and one disclosure issue. We determined the department fully implemented two recommendations, partially implemented five recommendations, and one recommendation is no longer applicable to the department.

Of the five recommendations partially implemented, one related to deposit of receipts in accordance with state law is again addressed beginning on page 16 of the report. The other four partially implemented recommendations all relate to Unemployment Insurance (UI) tax collections and reporting. These issues relate to deposits, billings, refunds, reporting, and penalty and interest and are discussed below.

UI Prior Audit Recommendations

UI Deposits

During the first 19 months of the current audit period (July 2000 through January 2002) the department was not consistently in compliance with federal regulations related to timely deposits of Unemployment Insurance tax collections. We found from January 2002 through August 2002 the department has met federal criteria, primarily because of a change in procedure implemented by the department in March 2002.

UI Billing

During the audit period the department made significant efforts to bill the Department of Labor and Industry (DOLI) for services related to UI in a timely manner in order to minimize the use of General Fund money to pay UI expenses.

As expenditures related to providing UI services are incurred, they are paid from a General Fund appropriation pending reimbursement from DOLI. The DOLI would not pay the amounts billed by the department because the rates and methods of billing had not been finalized in the fee-for-service contract between the two departments that was in effect for the period October 1, 2001 through

Prior Audit Recommendations

September 30, 2002. DOLI and the department did not finalize the agreement until June 2002. As a result, \$713,702 billed for the time period from October through June was not paid by DOLI until July. Department personnel believe they did everything possible to work with the DOLI to reach a final agreement.

UI Refunds

In the prior audit, we found that since the implementation of POINTS in December 1999, the department was not able to pay refunds required by state law to employers who overpaid their UI taxes. When employers overpay their UI taxes, state law provides the department can either issue the employer a refund or apply the amount against future tax liabilities. For over half of our two-year audit period, the department was not able to issue refunds. Since May 2002, the department has been able to issue refunds and personnel indicated the backlog of refunds should be eliminated by September 2002.

Summary

In each of the three issues discussed above related to UI deposits, UI billings, and UI refunds, we make no further recommendation to the department at this time based on the effort and progress made by the department on these issues.

Federal Reporting

In the cooperative agreement between the department and Department of Labor and Industry (DOLI) the department is required to prepare the ETA 581 and submit it to the DOLI by the 15th of the month following the end of each quarter. The ETA 581 is a federally required report concerning UI tax collections. DOLI must then submit the report to U.S. Department of Labor. During the prior audit we found that the department was unable to prepare the report in the time period required in the agreement because the department did not have the information required for the report.

During our current audit we found that although the department is now able to prepare the report, none of eight quarterly reports prepared during the audit period were submitted within the 15-day time established in the agreement. The reports ranged from 16 months to 1 month late, with each subsequent quarter showing

Prior Audit Recommendations

significant improvement. Department personnel said that because of the problems with the information necessary to prepare the reports, department personnel had to spend considerable time validating the data before the report could be sent. Department personnel indicated they believe the report for the quarter ended September 30 will be submitted to DOLI within the 15-day timeframe.

Recommendation #1

We recommend the department comply with UI tax reporting requirement contained in its contract with DOLI.

Penalty and Interest

In the prior audit report, we recommended the department assess penalties and interest for UI taxes in compliance with state law and analyze activity in the penalty and interest account and make necessary adjustments to correct the accounting records.

We found that during the audit period the penalty and interest defect in the POINTS system was corrected so penalty and interest can be properly assessed. However, because some of the UI data in POINTS may be unreliable, the basis for the penalty and interest calculation may not be correct. As a result, penalty and interest revenue for the special revenue fund may be misstated in fiscal years 2000-01 and 2001-02.

We found the department has done significant analysis of the revenue activity previously recorded in the penalty and interest account. In addition, current penalty and interest payments are being recorded correctly. However, the necessary transactions have not yet been recorded to correct the accounting records for the penalty and interest activity that was previously recorded incorrectly. As a result, fund balance and receivables in the penalty and interest account and the UI tax fund are misstated in fiscal years 2000-01 and 2001-02. Department personnel indicated that by the end of September, the corrections would be made to both POINTS and the accounting system. Until all corrections are made, department personnel could not provide an estimate of the misstatements.

Prior Audit Recommendations

Recommendation #2

We recommend the department determine and record the adjustments necessary to properly reflect penalty and interest activity on the accounting records.

Findings and Recommendations

Wage Base Tax Issues

The department is responsible for administering wage base taxes that consist of Unemployment Insurance (UI) and income tax withholding. During the audit we found the department has not been able to consistently, timely, and accurately perform three key aspects of administering the wage base tax functions during the audit period. Each of these issues is discussed below.

System to Identify, Bill and Collect from Employers

The department has been unable to, on a consistent and timely basis, identify, bill, and collect from employers who fail to report and pay wage base taxes. State law requires employers to file quarterly reports for withholding tax and UI tax.

The department has been unable to obtain information necessary to identify and notify employers who failed to file quarterly reports in a timely manner. In the last two fiscal years the department has obtained two delinquent report lists. The first report, which was created in March of 2001, identified delinquent filers for the quarters ended June 1999, September 1999, December 1999, and March 2000. The second report was dated in November 2001 and included quarters ended June 2000, September 2000, December 2000, March 2001, and June 2001. As of August 2002, no additional reports have been created to identify delinquent filers for the quarters ended September 2001, December 2001, March 2002, and June 2002. The November 2001 report identified over 8,900 delinquent reports for 2,000 employers. As of July 2002 of the 8,900 delinquent reports identified, approximately 5,700 of the reports have been filed. Department personnel indicated a report was run at the end of October that identified delinquent filers through the most recent quarter. Department personnel responsible for monitoring UI quarterly reports indicated they have had difficulties identifying delinquent filers using information currently available to them.

Employers are required to quarterly remit and report taxes due on wages paid during the quarter. The department processes the reports and money received separately. During the audit period department personnel did not consistently identify and follow-up with employers who may have remitted an amount different than the taxes due based

Findings and Recommendations

on wages paid and reported by the employer. Subsequent to fiscal year 2001-02, department personnel created a report that identifies employers who remitted out-of-balance reports and are currently in the process of verifying current quarterly information so they can follow-up with the employers. Until out of balance accounts are reviewed and information verified by department personnel, statements are not sent to employers notifying them of amounts due or if their account has a credit balance.

Department officials prepared a report to provide an estimate of the number of accounts they had not reviewed as of July 5, 2002. See Table 1 below for a summary of the information from the report by fiscal year, including the number of accounts and the potential over and under payments. Department personnel indicate a multitude of reasons may cause a quarterly report to be out of balance. Some of these include data input errors, taxpayer error, preexisting data errors, payment application methods, and the taxpayer did not remit the amount of taxes due based on wages paid and reported.

Table 1
Summary of Query on Out of Balance Reports
As of July 5, 2002

<u>Fiscal Year</u>	<u>Number of Accounts</u>	<u>Underpayment</u>	<u>Overpayments</u>
1989-1998	1,472	\$ 675,355	\$ 68,907
1999	5,341	1,624,736	444,103
2000	4,172	1,426,470	281,189
2001	3,900	1,912,020	309,961
2002	6,607	5,832,997	1,523,279
Total	<u>21,492</u>	<u>\$11,471,580</u>	<u>\$ 2,627,379</u>

Source: Compiled by Legislative Audit Division from department records.

As shown by the table above, the department has a significant number of out of balance reports from current and prior years that

Findings and Recommendations

have not yet been verified and as a result the legitimate underpayments have not been billed or collected by the department, and legitimate overpayments have not been credited to or refunded to employers. In addition, UI tax revenues in the Enterprise Fund and withholding tax revenue in the General Fund may be misstated.

Financial Activity

Because of the problems discussed above, the department was unable to identify and record on the accounting records at fiscal year end 2001-02 the amount of UI taxes that are due to the department but have not yet been received. An estimate for withholding taxes was recorded in conjunction with the income tax accrual. Department personnel indicated they could have taken information from the system to record an entry on the accounting records but chose not to record an entry that was known to contain errors. As a result, accounts receivable and revenue in the UI enterprise fund in fiscal year 2001-02 are misstated by the amount of UI taxes that are due to the department at June 30, 2002 but not recorded. Department personnel were not able to provide an estimate of the financial record misstatements.

Recommendation #3

We recommend the department:

- A. Obtain timely reports that identify employers who have not fully paid UI or withholding taxes.**
- B. Actively monitor and bill employers who have not fully paid wage base taxes due.**
- C. Correct data errors, correct POINTS defects, and provide additional training to personnel.**
- D. Determine and record on the accounting records taxes owed to the department which have not yet been received.**

System to Calculate and Adjust UI Contribution Tax Rates

As part of the department's UI tax administration responsibilities the department calculates on a calendar basis the UI tax rate for approximately 35,000 employers. The computation of the employer's annual tax rate is based on State Unemployment

Findings and Recommendations

Insurance laws. We found problems with the computer system used to calculate the rate may have caused errors to occur in the UI tax rate in calendar years 2001 and 2002 for some employers. In addition, we found the department does not have an adequate control system to determine whether manual changes made to UI rates during the audit period were appropriate.

State law, section 39-51-1219, MCA, requires that experience factors used to calculate the UI rate be applied in certain situations to successor employers. The computer system did not properly transfer the experience rating from previous employers to successor employers. As a result, the rate calculated by the department for calendar years 2001 and 2002 may be incorrect for 925 employers. In addition, UI tax revenue in the Enterprise Fund may be misstated.

In addition, because of potential errors in employer account data, some of the tax data in the POINTS system for employers may be unreliable. Since taxes paid are a factor in the experience ratio, additional employer rates could possibly be incorrect. Department personnel could not provide an estimate of the number of accounts affected by the employer account errors.

The department calculates and sends out notices of the UI tax rates to all employers by April 1 each year. During the audit period department personnel often received calls from employers who had questions about their rates. Department personnel would then research the rates to determine if the rates were incorrect. In some cases, based on department research the employer rate was found to be incorrect, the rate was adjusted. No documentation was maintained that shows which employers called and whether the rates were adjusted during the calendar 2001 process. A spreadsheet was maintained for tracking purposes during the calendar 2002 process. Department personnel could not provide an estimate of the number of employers who called or how many rates were adjusted for 2001 and estimated a total of 450 employers either called or wrote a letter requesting their rate be reviewed for 2002 rates.

Findings and Recommendations

Because documentation was not maintained of the rate adjustments to calendar year 2001 rates, no supervisory review was possible to ensure the rate changes were correct and appropriate or if rates should have been changed and were not. According to department personnel, some of the rate changes for calendar year 2002 were reviewed by an employee; however, that employee's rate changes were not reviewed. Without documentation and supervisory reviews controls are not adequate to ensure changes to UI rates are appropriate.

Department personnel indicated that correcting the problems in the rate calculation is a priority and are optimistic that the calendar year 2003 rates will be correct. We believe the department should establish controls to ensure that rate changes are appropriate.

Recommendation #4

We recommend the department:

- A. Accurately calculate UI rates as required by state law.**
- B. Establish controls over UI rate inquiries and adjustments.**

Management Controls Over Travel Advances

The department provides employees who travel on a regular or extended basis the opportunity to receive permanent travel advances. These advances pay the cost of department related travel until the expenses can be reimbursed to the employee. At the time an advance is given the employee signs an agreement which requires the advance to be returned to the department upon termination. The department also utilizes temporary travel advances. These advances are used when an employee will travel for a specific time or to a specific event. At the end of the travel a travel expense claim is filed and the employee is either reimbursed for costs incurred above the advance or repayment for the amount of the advance not used is requested.

At the end of fiscal years 2000-01 and 2001-02 the department had a total of \$53,970 and \$58,042, respectively, in permanent travel

Findings and Recommendations

advances outstanding. In fiscal year 2001-02 this balance consisted of 106 separate advances, which had been granted beginning in July of 1976. Advances range in amount from \$150 to \$4,000.

While reviewing the advance listing we noted the issues discussed below :

- ▶ One employee has a permanent travel advance totaling \$4,000. This advance consists of \$1,000 and \$3,000 advances received on October 8, 1998 and May 15, 2000, respectively. According to department personnel, the advances received by the employee were not intended to be permanent. The employee submitted completed travel expense claim forms in October of 1998 and May of 2000 and was reimbursed for the travel expenses that the advances were meant to cover. Department personnel stated an oversight allowed the travel expenses to be both advanced and reimbursed and for the advance to remain at \$4,000 for over two years.
- ▶ We noted an employee who was no longer employed by the department but still had a \$500 advance outstanding. This employee terminated employment with the department on May 18, 2001. According to department personnel the advance was to be collected from the employee's final paycheck. The information was entered correctly to SABHRS but because of the timing of the final paycheck the amount was not withheld. Department personnel did not verify that the funds had been withheld from the employee's final check. The travel advance remained outstanding on department records.
- ▶ The travel advance listing shows several employees of the department who are no longer employed in positions that require regular or extended travel. We reviewed the list and reviewed individual employees who had permanent travel advances to determine if the employees have submitted travel expense claim forms. We noted several employees on the listing had turned in no travel claims during fiscal year 2001-2002.

Department personnel indicated that a yearly review of travel advances was eliminated a few years ago due to controls in place for monitoring who has a travel advances at the department. We believe, however, given the items discussed above, the department

Findings and Recommendations

should establish management controls that include a periodic review and evaluation of permanent travel advances outstanding.

Recommendation #5

We recommend the department establish management controls to ensure permanent travel advances are reasonable and necessary.

Liquor Receivables

The department's liquor division serves as the central purchasing facility for the approximately 100 privately owned agency liquor stores in the state. Agency stores then purchase inventory from the liquor division. The purchase of liquor from the vendor and the sale of the liquor to the agency store are done simultaneously by the state through a "bailment" system.

Currently, under section 16-2-101(2)(b)(ii)(C), MCA, the liquor division allows 60 days from the date of purchase for agency stores to pay for liquor that they have purchased. However, the "bailment" agreement requires the department to pay the vendor for the liquor in 30 days or less.

We calculated the potential interest cost to the state caused by the 30-day difference in the time that payments are made to the vendor and payments are received from the agency stores. We estimate the state General Fund loses approximately \$28,000 in interest each month, or a total of approximately \$672,000 during the two-year audit period.

The department had an accounts receivable balance of approximately \$11 million at the end of fiscal year 2001-02 from agency stores. The department should consider and decide the best option so the payment terms from the agency stores are the same terms as the state's payment to the vendors. This will require the department to either renegotiate the "bailment" agreement or seek legislation to reduce the payment term to the agency stores.

Findings and Recommendations

Recommendation #6

We recommend the department take necessary action so the terms for payment from agency stores are the same terms as the state's payment to the vendors.

Noncompliance With State Laws

The department is responsible for the implementation and monitoring of laws contained in 14 different titles of the Montana Code Annotated. The laws relate to various functions including the assessment and collection of taxes and fees, the control of liquor sales and licensing, and the distribution of funds collected by counties. Taxes and assessments collected by the department include income, property, and unemployment insurance. The following section notes areas where the department was not in compliance with specific laws related to these functions.

Timely Deposits

- ▶ Section 17-6-105, MCA, requires agencies to deposit daily when total collections exceed \$500. In the previous audit of the department we noted the department did not comply with this section of law. Department personnel stated, beginning on April 15, 2002 and until May 6, 2002 the department was not able to deposit in accordance with the law because of the volume of returns received. Department personnel believe, given the cyclical nature of tax returns, it would not be cost beneficial or practical to employ adequate staff or obtain additional equipment necessary to comply with the law.

UI Notification

- ▶ Section 39-51-1206, MCA, requires the employers to file a written request with the department for a re-determination or hearing related to their unemployment insurance tax rate. We found during the audit period that personnel adjusted rates without a written request from the employer as required by the law in instances when department personnel agreed with the employer about an error.

Automatic Extensions

- ▶ Section 15-31-111, MCA, states an automatic extension is granted for up to six months from the original date of required filing for corporations required to file a tax return in Montana. Section 15-31-141, MCA, provides for an extension of 1 to 6 months for corporate consolidated returns if an application is filed with the department prior to the due date of the return. Department personnel stated they believe that section 15-31-111, MCA, provided for an exemption from the requirements of

Findings and Recommendations

section 15-31-141, MCA, and have been allowing for an automatic extension of six months.

Rules for Tax Credits

- ▶ The department is responsible for adopting rules related to the tax credit for research expenses and payments allowed for under section 15-31-150, MCA. Currently, the department has not promulgated rules for receiving the credit. The department follows the Internal Revenue Service rules, however, these rules do not substitute for the rules required by state law.

Residential Property Tax Credit

- ▶ Elderly taxpayers in the state are allowed to apply for a residential property tax credit. The department does not keep a record of the extensions or the reason for granting the extension as required by state law. Department personnel stated there are between 12 and 24 extensions applied for each year, and to establish a monitoring system to track this number of returns would not be cost effective.

Coal Tax Bond Fund

- ▶ Section 17-5-703, MCA, requires that the department retain, in the coal severance tax bond fund, the amount necessary to meet all principal and interest payments. We found that from May 21, 2002 until July 30, 2002, the department was not in compliance with this law. When we brought this issue to the attention of department personnel, a transaction was entered to correct the entry.

The issues above show instances where the department does not comply with various laws. Some of the laws conflict while compliance with others, according to department personnel, would be too costly.

Recommendation #7

We recommend the department:

- A. Comply with the state laws noted above.**
- B. If necessary, seek legislation to amend the laws.**

County Collections

Chapter 574, Laws of 2001, moved the responsibility for the county collections process to the Department of Revenue. At the end of fiscal year 2001-02 the department accrued, as required by state accounting policy, the amount of revenue collected by the counties

Findings and Recommendations

but not yet remitted to the department. In an attempt to get the most accurate information on the state's accounting records, department personnel chose to wait to make the accrual until the county collection reports for June were received. When the calculation of the accrual was performed using the county reports, the department made errors and the amounts accrued resulted in overstatements of revenue for fiscal year 2001-02. The information below shows the effect of the accrual errors on the funds on a statewide basis.

<u>Fund</u>	<u>Fiscal Year 2001-02 Overstatement</u>
General	\$2,584,542
Special Revenue	540,732
Agency	25,048
Enterprise	<u>1,907</u>
Total	<u><u>\$3,152,229</u></u>

Department personnel stated the errors occurred because reports from counties did not arrive in the time frame required by law, which gave them little time to prepare the accrual amount.

Recommendation #8

We recommend the department:

- A. Establish procedures to ensure counties submit collection reports in a timely manner as required by law.**
- B. Ensure accrual calculations are correct prior to recording them on the state's accounting system.**

Independent Auditor's Report & Department Financial Schedules

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
John W. Northey, Legal Counsel



Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
Tori Hunthausen, IS Audit & Operations
James Gillett, Financial-Compliance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Schedules of Changes in Fund Balances & Property Held in Trust, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Department of Revenue for each of the fiscal years ended June 30, 2001 and 2002. The information contained in these financial schedules is the responsibility of the department's management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosure in the financial schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 1, the financial schedules are presented on a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The schedules are not intended to be a complete presentation and disclosure of the department's assets, liabilities and cash flows.

Because of an error made by the Board of Investments when recording unrealized investment earnings during fiscal year 2001-02, investment earnings are overstated by \$12,380,753 in the Permanent Fund on the Schedule of Total Revenue & Transfer-In for fiscal year 2001-02.

In our opinion, except for the effects of the error in recording unrealized investment income as discussed in the preceding paragraph, the financial schedules referred to above present fairly, in all material respects, the results of operations and changes in fund balances of the Department of Revenue for each of the fiscal years ended June 30, 2001 and 2002, in conformity with the basis of accounting described in note 1.

Respectfully submitted,

(Signature on File)

James Gillett, CPA
Deputy Legislative Auditor

September 24, 2002

DEPARTMENT OF REVENUE
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 2002

	<u>General Fund</u>	<u>Special Revenue Fund</u>	<u>Debt Service Fund</u>	<u>Capital Projects Fund</u>	<u>Enterprise Fund</u>	<u>Internal Service Fund</u>	<u>Agency Fund</u>	<u>Private Purpose Trust Fund</u>	<u>Permanent Fund</u>
FUND BALANCE: July 1, 2001	\$ (3,072,799)	\$ 14,097,418	\$ 69,481	\$ 9,563,929	\$ 1,722,744	\$ 534,967	\$ 2,612	\$ 0	\$ 761,449,807
PROPERTY HELD IN TRUST: July 1, 2001							\$ 21,604,026		
ADDITIONS									
Budgeted Revenues & Transfers-In	924,217,245	101,525,937	300,333	5,505,178	51,374,376	128,230			88,669,554
NonBudgeted Revenues & Transfers-In	1,078,986	1,024,532			17,512,388		(492)	216,112	14,393,877
Prior Year Revenues & Transfers-In Adjustments	845,977	5,191,580	(3,738)	(40,530)	(9,906,989)	206	492	150,518	103,617
Direct Entries to Fund Balance	(801,749,167)	(65,889,581)	(295,255)	(5,490,734)	671,250	50,168	(2,363)	268,686	(495,334)
Additions to Property Held in Trust							4,263,028		
Total Additions	<u>124,393,041</u>	<u>41,852,468</u>	<u>1,340</u>	<u>(26,086)</u>	<u>59,651,025</u>	<u>178,604</u>	<u>4,260,665</u>	<u>635,316</u>	<u>102,671,714</u>
REDUCTIONS									
Budgeted Expenditures & Transfers-Out	126,287,815	40,088,792		4,579,793	56,744,022	119,447			
NonBudgeted Expenditures & Transfers-Out	21	697,038			228,263	(283,398)			65,969,368
Prior Year Expenditures & Transfers-Out Adjustments	19,123	6,195,830		(65,028)	(336,461)	391,674		204,374	
Reductions in Property Held in Trust							23,646,420		
Total Reductions	<u>126,306,959</u>	<u>46,981,660</u>	<u>0</u>	<u>4,514,765</u>	<u>56,635,824</u>	<u>227,723</u>	<u>23,646,420</u>	<u>204,374</u>	<u>65,969,368</u>
FUND BALANCE: June 30, 2002	\$ <u>(4,986,717)</u>	\$ <u>8,968,226</u>	\$ <u>70,821</u>	\$ <u>5,023,078</u>	\$ <u>4,737,945</u>	\$ <u>485,848</u>	\$ <u>249</u>	\$ <u>430,942</u>	\$ <u>798,152,153</u>
PROPERTY HELD IN TRUST: June 30, 2002							\$ <u>2,220,634</u>		

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF REVENUE
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 2001

	General Fund	Special Revenue Fund	Debt Service Fund	Capital Projects Fund	Enterprise Fund	Internal Service Fund	Agency Fund	Expendable Trust Fund	Nonexpendable Trust Fund
FUND BALANCE: July 1, 2000	\$ (443,269)	\$ 11,934,516	\$ 16,638	\$ 17,850,638	\$ 3,653,576	\$ (751,400)	\$ (1,663)	\$ 1,859,907	\$ 699,574,913
PROPERTY HELD IN TRUST: July 1, 2000							\$ 10,788,994		
ADDITIONS									
Budgeted Revenues & Transfers-In	1,023,752,513	135,037,342	307,203	5,678,281	54,681,946	8,890,284		(572,083)	80,591,937
NonBudgeted Revenues & Transfers-In	1,273,883	1,695,306			10,192,035	112,579	(165,835)	40,864	14,621,826
Prior Year Revenues & Transfers-In Adjustments	(12,358,983)	(894,621)	24,255	339,710	(11,729,479)	(259,164)	165,835	(37,990)	15,148,912
Direct Entries to Fund Balance	(919,128,109)	(61,514,680)	(278,615)	(5,279,883)	43,983	(2)	4,276		(560,203)
Additions To Property Held in Trust							30,167,474		
Total Additions	93,539,304	74,323,347	52,843	738,108	53,188,485	8,743,697	30,171,750	(569,209)	109,802,472
REDUCTIONS									
Budgeted Expenditure & Transfers-Out	96,135,011	70,906,701		7,806,862	54,554,109	7,340,072			
NonBudgeted Expenditure & Transfers-Out	(13,080,657)	(1,984,021)		1,217,955	556,531	(73,951)			65,457,466
Prior Year Expenditure & Transfers-Out Adjustments	13,114,480	4,528,463			8,677	191,209			(17,529,888)
Reductions in Property Held in Trust							19,352,442		
Total Reductions	96,168,834	73,451,143	0	9,024,817	55,119,317	7,457,330	19,352,442	0	47,927,578
FUND BALANCE: June 30, 2001	\$ (3,072,799)	\$ 12,806,720	\$ 69,481	\$ 9,563,929	\$ 1,722,744	\$ 534,967	\$ 2,612	\$ 1,290,698	\$ 761,449,807
PROPERTY HELD IN TRUST: June 30, 2001							\$ 21,604,026		

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2002

	General Fund	Special Revenue Fund	Debt Service Fund	Capital Projects Fund	Enterprise Fund	Internal Service Fund	Agency Fund	Private Purpose Trust Fund	Permanent Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS										
Licenses and Permits	\$ 6,066,416	\$ 56,624			\$ 2,128,726					\$ 8,251,766
Taxes	844,711,950	78,916,659	\$ 296,595	\$ 5,464,648	12,926,573				\$ 17,895,566	960,211,991
Charges for Services	187,706	6,169,636			5,650	\$ 128,436				6,491,428
Investment Earnings								\$ 7,447	69,245,645	69,253,092
Fines and Forfeits	75	268,371			91,127					359,573
Sale of Documents, Merchandise and Property					43,412,861					43,412,861
Contributions and Premiums		6,093,588			415,453					6,509,041
Miscellaneous	230,709				(615)					230,094
Grants, Contracts, Donations and Abandonments	1,219,964	134,196						359,183		1,713,343
Other Financing Sources	54,478,654	15,952,977							16,025,837	86,457,468
Federal	19,240,092	149,998								19,390,090
Federal Indirect Cost Recoveries	6,642									6,642
Total Revenues & Transfers-In	926,142,208	107,742,049	296,595	5,464,648	58,979,775	128,436	0	366,630	103,167,048	1,202,287,389
Less: Nonbudgeted Revenues & Transfers-In	1,078,986	1,024,532	0	0	17,512,388	0	(492)	216,112	14,393,877	34,225,403
Prior Year Revenues & Transfers-In Adjustments	845,977	5,191,580	(3,738)	(40,530)	(9,906,989)	206	492	150,518	103,617	(3,658,867)
Actual Budgeted Revenues & Transfers-In	924,217,245	101,525,937	300,333	5,505,178	51,374,376	128,230	0	0	88,669,554	1,171,720,853
Estimated Revenues & Transfers-In	1,511,279,804	109,962,982	238,000	5,812,000	66,505,648	14,766,896	0	0	52,124,102	1,760,689,432
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ (587,062,559)	\$ (8,437,045)	\$ 62,333	\$ (306,822)	\$ (15,131,272)	\$ (14,638,666)	\$ 0	\$ 0	\$ 36,545,452	\$ (588,968,579)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS										
Licenses and Permits	\$ 391,388	\$ (161,312)			\$ 603,726					\$ 833,802
Taxes	(581,266,960)	(5,235,226)	\$ 62,333	\$ (306,822)	(210,427)				\$ 16,804,051	(570,153,051)
Charges for Services	5,864	355,067			650	\$ (14,638,666)				(14,277,085)
Investment Earnings		(50,000)							19,741,401	19,691,401
Fines and Forfeits	(100)	(131,629)			16,128					(115,601)
Sale of Documents, Merchandise and Property	(1,000)				(9,638,580)					(9,639,580)
Rentals, Leases and Royalties					(500)					(500)
Contributions and Premiums		434,588			(5,887,269)					(5,452,681)
Miscellaneous	(1,100)	(211,538)			(15,000)					(227,638)
Grants, Contracts, Donations and Abandonments	(972,604)	150,033								(822,571)
Other Financing Sources	(3,219,240)	(3,508,024)								(6,727,264)
Federal	(1,983,807)	(79,004)								(2,062,811)
Federal Indirect Cost Recoveries	(15,000)									(15,000)
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ (587,062,559)	\$ (8,437,045)	\$ 62,333	\$ (306,822)	\$ (15,131,272)	\$ (14,638,666)	\$ 0	\$ 0	\$ 36,545,452	\$ (588,968,579)

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DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2001

	General Fund	Special Revenue Fund	Debt Service Fund	Capital Projects Fund	Enterprise Fund	Internal Service Fund	Agency Fund	Expendable Trust Fund	Nonexpendable Trust Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS										
Licenses and Permits	\$ 5,473,990	\$ 227,416			\$ 1,702,845					\$ 7,404,251
Taxes	931,182,380	109,051,312	\$ 331,458	\$ 6,017,991	12,254,400	\$ 263			\$ 18,616,152	1,077,453,956
Charges for Services	158,326	5,362,221			5,894	5,931,120				11,457,561
Investment Earnings								\$ 13,333	77,435,366	77,448,699
Fines and Forfeits		457,006			81,166					538,172
Sale of Documents, Merchandise and Property					39,098,065					39,098,065
Contributions and Premiums		6,138,405						(610,073)		5,528,332
Miscellaneous	228,230				(869)					227,361
Grants, Contracts, Donations and Abandonments	1,977,259	150,702			3,000			27,531		2,158,492
Other Financing Sources	36,741,532	14,328,889				2,812,316			14,311,157	68,193,894
Federal	36,899,675	122,076								37,021,751
Federal Indirect Cost Recoveries	6,021									6,021
Total Revenues & Transfers-In	1,012,667,413	135,838,027	331,458	6,017,991	53,144,501	8,743,699	0	(569,209)	110,362,675	1,326,536,555
Less: Nonbudgeted Revenues & Transfers-In	1,273,883	1,695,306	0	0	10,192,035	112,579	(165,835)	40,864	14,621,826	27,770,658
Prior Year Revenues & Transfers-In Adjustments	(12,358,983)	(894,621)	24,255	339,710	(11,729,480)	(259,164)	165,835	(37,990)	15,148,912	(9,601,526)
Actual Budgeted Revenues & Transfers-In	1,023,752,513	135,037,342	307,203	5,678,281	54,681,946	8,890,284	0	(572,083)	80,591,937	1,308,367,423
Estimated Revenues & Transfers-In	951,835,544	89,068,039	268,000	4,146,005	52,579,501	12,165,896	0	61,000,000	63,685,407	1,234,748,392
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ 71,916,969	\$ 45,969,303	\$ 39,203	\$ 1,532,276	\$ 2,102,445	\$ (3,275,612)	\$ 0	\$ (61,572,083)	\$ 16,906,530	\$ 73,619,031
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS										
Licenses and Permits	\$ (219,286)	\$ 41,908			\$ 177,845					\$ 467
Taxes	62,451,465	43,136,921	\$ 39,203	\$ 2,092,281	1,353,612				\$ 10,303,746	119,377,228
Charges for Services	(123,354)	907,659			895	\$ (5,975,609)				(5,190,409)
Investment Earnings		(174,010)		(560,003)					22,288,483	21,554,470
Fines and Forfeits	(100)	57,038			6,166					63,104
Sale of Documents, Merchandise and Property	(1,000)				579,427					578,427
Rentals, Leases and Royalties					(500)					(500)
Contributions and Premiums		1,747,787						\$ (61,572,083)		(59,824,296)
Miscellaneous	(1,100)	(401,245)			(15,000)					(417,345)
Grants, Contracts, Donations and Abandonments	291,952	20,086								312,038
Other Financing Sources	(3,229,482)	2,547,565		(2)		2,699,997			(15,685,699)	(13,667,621)
Federal	12,762,874	(1,914,406)								10,848,468
Federal Indirect Cost Recoveries	(15,000)						\$			(15,000)
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ 71,916,969	\$ 45,969,303	\$ 39,203	\$ 1,532,276	\$ 2,102,445	\$ (3,275,612)	\$ 0	\$ (61,572,083)	\$ 16,906,530	\$ 73,619,031

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF REVENUE SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT FOR THE FISCAL YEAR ENDED JUNE 30, 2002							
PROGRAM (SUB-CLASS) EXPENDITURES & TRANSFERS-OUT	COMPLIANCE VALUATION AND RESOLUTION	CUSTOMER SERVICE CENTER	DIRECTOR'S OFFICE	INFORMATION TECHNOLOGY	R01	RESOURCE MANAGEMENT	Total
Personal Services							
Salaries	\$ 11,633,923	\$ 2,908,048	\$ 1,641,471	\$ 1,426,831		\$ 1,342,183	\$ 18,952,456
Hourly Wages	553						553
Other Compensation	1,102	50	225				1,377
Employee Benefits	3,319,407	858,847	386,013	354,421		362,010	5,280,698
Personal Services-Other		(331)				(14,948)	(15,279)
Total	14,954,985	3,766,614	2,027,709	1,781,252		1,689,245	24,219,805
Operating Expenses							
Other Services	1,827,947	1,306,662	4,851,454	592,137		154,121	8,732,321
Supplies & Materials	710,303	110,237	131,049	72,916		118,467	1,142,972
Communications	713,923	359,419	44,866	25,946		67,195	1,211,349
Travel	326,167	28,977	24,628	13,903		8,359	402,034
Rent	996,651	106,478	72,264	41,753		89,543	1,306,689
Utilities	7,323	311				45,480	53,114
Repair & Maintenance	128,200	80,643	10,888	14,138		34,332	268,201
Other Expenses	247,516	173,181	39,467	34,214		247,031	741,409
Goods Purchased For Resale						35,214,835	35,214,835
Total	4,958,030	2,165,908	5,174,616	795,007		35,979,363	49,072,924
Equipment & Intangible Assets							
Equipment	17,454		18,392	20,047		(31,795)	24,098
Total	17,454		18,392	20,047		(31,795)	24,098
Local Assistance							
From State Sources	52,261,545		88,961,397			156,408	141,379,350
Total	52,261,545		88,961,397			156,408	141,379,350
Transfers							
Accounting Entity Transfers	16,413,394	623,227	(65,028)		(341,651)	69,507,939	86,137,881
Total	16,413,394	623,227	(65,028)		(341,651)	69,507,939	86,137,881
Debt Service							
Installment Purchases	6,615						6,615
Total	6,615						6,615
Total Expenditures & Transfers-Out	\$ 88,612,023	\$ 6,555,749	\$ 96,117,086	\$ 2,596,306	\$ (341,651)	\$ 107,301,160	\$ 300,840,673
EXPENDITURES & TRANSFERS-OUT BY FUND							
General Fund	\$ 27,588,582	\$ 3,798,471	\$ 91,570,644	\$ 2,150,381		\$ 1,198,881	\$ 126,306,959
Special Revenue Fund	44,479,484	1,766,080	1,100	374,214	\$ 204,374	156,408	46,981,660
Capital Projects Fund			4,514,765				4,514,765
Enterprise Fund		762,765	30,577	71,711		55,770,771	56,635,824
Internal Service Fund		228,433				(710)	227,723
Private Purpose Trust Fund	204,374						204,374
Permanent Fund	16,339,583				(546,025)	50,175,810	65,969,368
Total Expenditures & Transfers-Out	88,612,023	6,555,749	96,117,086	2,596,306	(341,651)	107,301,160	300,840,673
Less: Nonbudgeted Expenditures & Transfers-Out	16,413,415	345,918			(546,025)	50,397,984	66,611,292
Prior Year Expenditures & Transfers-Out Adjustments	6,240,596	386,295	(60,896)	1,924	204,374	(362,781)	6,409,512
Actual Budgeted Expenditures & Transfers-Out	65,958,012	5,823,536	96,177,982	2,594,382	0	57,265,957	227,819,869
Budget Authority	83,756,444	5,864,189	100,257,539	2,609,493	0	66,742,675	259,230,340
Unspent Budget Authority	\$ 17,798,432	\$ 40,653	\$ 4,079,557	\$ 15,111	\$ 0	\$ 9,476,718	\$ 31,410,471
UNSPENT BUDGET AUTHORITY BY FUND							
General Fund	\$ 269,820	\$ 9,035	\$ 76,076	\$ 11,669		\$ 2,073	\$ 368,673
Special Revenue Fund	17,528,612	21,065		3,442		29,511	17,582,630
Capital Projects Fund			4,003,481				4,003,481
Enterprise Fund						9,445,134	9,445,134
Internal Service Fund		10,553					10,553
Unspent Budget Authority	\$ 17,798,432	\$ 40,653	\$ 4,079,557	\$ 15,111	\$ 0	\$ 9,476,718	\$ 31,410,471

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2001

PROGRAM (SUB-CLASS) EXPENDITURES & TRANSFERS-OUT	PROGRAM (SUB-CLASS) NOT SPECIFIED	COMPLIANCE VALUATION AND RESOLUTION	CUSTOMER SERVICE AND INFORMATION PROCESSING	DIRECTOR'S OFFICE	INFORMATION TECHNOLOGY	RESOURCE MANAGEMENT	Total
PERSONAL SERVICES							
SALARIES		\$ 10,858,053	\$ 3,007,118	\$ 1,631,677	\$ 1,288,882	\$ 1,404,540	\$ 18,190,270
OTHER COMPENSATION				50			50
EMPLOYEE BENEFITS		3,050,133	880,340	377,363	313,214	373,015	4,994,065
PERSONAL SERVICES-OTHER	\$ 31,742						31,742
Total	31,742	13,908,186	3,887,458	2,009,090	1,602,096	1,777,555	23,216,127
Operating Expenses							
Other Services		5,416,236	1,310,270	8,325,296	473,448	609,840	16,135,090
Supplies & Materials		501,037	220,788	190,969	229,128	86,688	1,228,610
COMMUNICATIONS		390,619	585,860	28,759	32,534	43,615	1,081,387
TRAVEL		380,641	33,803	40,014	17,069	9,367	480,894
Rent		922,597	124,717	65,157	49,611	65,646	1,227,728
UTILITIES		7,935	178			50,512	58,625
REPAIR & MAINTENANCE		125,745	110,884	9,330	21,486	24,358	291,803
OTHER EXPENSES	84,205	258,250	144,539	45,187	50,072	535,975	1,118,228
GOODS PURCHASED FOR RESALE						33,432,400	33,432,400
Total	84,205	8,003,060	2,531,039	8,704,712	873,348	34,858,401	55,054,765
Equipment & Intangible Assets							
Equipment	(75,016)	122,473		17,252		92,338	157,047
INTANGIBLE ASSETS				699			699
INSTALLMENT PURCHASES-EQUIP-NB		9,587					9,587
Total	(75,016)	132,060		17,951		92,338	167,333
LOCAL ASSISTANCE							
FROM STATE SOURCES		136,603,629				4,306,467	140,910,096
Total		136,603,629				4,306,467	140,910,096
TRANSFERS							
ACCOUNTING ENTITY TRANSFERS		11,478,933	954,967	3,917,955		53,443,436	69,795,291
Total		11,478,933	954,967	3,917,955		53,443,436	69,795,291
Debt Service							
INSTALLMENT PURCHASES		5,407					5,407
Total		5,407					5,407
Total Expenditures & Transfers-Out	\$ 40,931	\$ 170,131,275	\$ 7,373,464	\$ 14,649,708	\$ 2,475,444	\$ 94,478,197	\$ 289,149,019
EXPENDITURES & TRANSFERS-OUT BY FUND							
General Fund		\$ 87,448,402		\$ 5,482,633	\$ 1,985,161	\$ 1,252,638	\$ 96,168,834
Special Revenue Fund		68,371,716	\$ 611,432		161,528	4,306,467	73,451,143
Capital Projects Fund				9,024,817			9,024,817
Enterprise Fund	\$ 21,955					55,097,362	55,119,317
Internal Service Fund	18,976		6,762,032	142,258	328,755	205,309	7,457,330
Nonexpendable Trust Fund		14,311,157				33,616,421	47,927,578
Total Expenditures & Transfers-Out	40,931	170,131,275	7,373,464	14,649,708	2,475,444	94,478,197	289,149,019
Less: Nonbudgeted Expenditures & Transfers-Out	92,182	14,320,744	513,127	1,217,955		35,949,315	52,093,323
Prior Year Expenditures & Transfers-Out Adjustments	(51,251)	1,964,173	196,587	7,794	2,469	(1,806,831)	312,941
Actual Budgeted Expenditures & Transfers-Out	0	153,846,358	6,663,750	13,423,959	2,472,975	60,335,713	236,742,755
Budget Authority	0	168,083,569	6,772,795	22,093,348	2,501,416	61,432,757	260,883,885
Unspent Budget Authority	\$ 0	\$ 14,237,211	\$ 109,045	\$ 8,669,389	\$ 28,441	\$ 1,097,044	\$ 24,141,130
UNSPENT BUDGET AUTHORITY BY FUND							
General Fund		\$ 2,799,141		\$ 86,115	\$ 5,904	\$ 2,313	\$ 2,893,473
Special Revenue Fund		11,438,070			22,537	256,883	11,717,490
Capital Projects Fund				8,583,274			8,583,274
Enterprise Fund						837,848	837,848
Internal Service Fund			\$ 109,045				109,045
Unspent Budget Authority	\$ 0	\$ 14,237,211	\$ 109,045	\$ 8,669,389	\$ 28,441	\$ 1,097,044	\$ 24,141,130

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

Department of Revenue

Notes to the Financial Schedules

For the Two Fiscal Years Ended June 30, 2002

1. Summary of Significant Accounting Policies

Basis of Accounting

The department uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental fund category (General, Special Revenue, Capital Projects, Debt Service, and Permanent Funds) and certain liabilities of defined benefit pension plans and certain post employment healthcare plans. In applying the modified accrual basis, the department records:

Revenues when it receives cash or when receipts are measurable and available to pay current period liabilities.

Expenditures for valid obligations when the department incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. State accounting policy requires the department to record the cost of employees' annual leave and sick leave when used or paid.

The department uses accrual basis accounting for its Proprietary (Enterprise and Internal Service) and Fiduciary fund categories (Private-Purpose Trust, and Agency). Under the accrual basis, as defined by state accounting policy, the department records revenues in the accounting period earned when measurable and records expenses in the period incurred when measurable.

Expenditures and expenses may include: entire budgeted service contracts even though the department receives the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

Notes to the Financial Schedules

Basis of Presentation

The financial schedule format is in accordance with the policy of the Legislative Audit Committee. The financial schedules are prepared from the transactions posted to the state's accounting system without adjustment.

The 2001 Legislature modified the fund structure established in section 17-2-102, MCA, to implement the changes made to generally accepted accounting principles (GAAP) by Governmental Accounting Standards Board (GASB) Statement 34. These changes were effective July 1, 2001. Department accounts are organized in funds according to state law applicable at the time transactions were recorded. The department uses the following funds:

Governmental Fund Category

General Fund - to account for all financial resources except those required to be accounted for in another fund.

Special Revenue Fund - to account for proceeds of specific revenue sources (other than private purpose trusts or major capital projects) that are legally restricted to expenditures for specific purposes. In fiscal year 2000-01, the department had Expendable Trust Funds which included Unemployment Insurance tax fund, Unclaimed Property, and Escheated Estates. Except for Unemployment Insurance tax fund, these are recorded in the Special Revenue Fund in fiscal year 2002. Other department Special Revenue Funds include Corporation Tax-Financial Institution, Oil & Gas Production Tax, Coal Tax, Alcohol Tax, Accommodations Tax, and University Millage.

Debt Service Fund - to account for accumulated resources for the payment of general long-term debt principal and interest. The department uses this fund for the Long Range Building Program and the Renewable Resource Bond Funds.

Capital Projects Fund - to account for financial resources used for the acquisition or construction of major capital facilities, other than those financed by proprietary funds or trust funds. The department

Notes to the Financial Schedules

uses this fund for the Long Range Building Program and funding for its POINTS system.

Permanent Fund – to account for financial resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that support the department programs. In fiscal year 2000-01 this activity was reported under the Nonexpendable Trust Fund. The department uses this fund for the Permanent Coal Trust Fund, the Cultural Trust, the Coal Severance Tax Income and Bond Funds, the Resource Indemnity Trust Fund, Common School Trust Fund, and the Treasure State Endowment and Income Funds.

Proprietary Fund Category

Internal Service Fund - to account for the financing of goods or services provided by one department or agency to other departments or agencies of state government or to other governmental entities on a cost-reimbursement basis. The department's Internal Service Fund is bad debt collection in fiscal year 2001-02. In fiscal year 2000-01 the Customer Service Center was also an Internal Service Fund.

Enterprise Fund - to account for operations (a) financed and operated in a manner similar to private business enterprises, where the Legislature intends that the department finance or recover costs primarily through user charges; or (b) where the Legislature has decided that periodic determination of revenues earned, expenses incurred or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes. Department Enterprise Funds includes the liquor division and Unemployment Insurance (UI) tax fund in fiscal year 2001-02. In fiscal year 2000-01 the UI tax fund was an Expendable Trust Fund.

Fiduciary Fund Category

Private-purpose Trust Fund – to account for activity of all other trust arrangements under which principal and income benefit individuals, private organizations, or other governments. This fund did not exist in fiscal year 2000-01 under the previous fund structure. Department private-purpose trust funds are used to account for

Notes to the Financial Schedules

unclaimed and escheat property. In fiscal year 2000-01 these funds were Expendable Trust Funds.

Agency Fund – to account for resources held by the state in a purely custodial capacity. The department uses the Agency Fund as a clearing account to facilitate the distribution of gas and oil taxes, one-stop licensing, county collections, and bad debt collections.

2. General Fund Balance (negative balances)

The negative fund balance in the General Fund does not indicate overspent appropriation authority. Each agency has authority to pay obligations from the statewide General Fund within its appropriation limits. Each agency expends cash or other assets from the statewide fund when it pays General Fund obligations. The department's outstanding liabilities exceed the assets the agency has placed in the fund, resulting in negative ending General Fund balances for each of the two fiscal years ended June 30, 2001 and June 30, 2002.

3. Expenditure Program (Subclass)

Non-Budgeted Activity Lacking Subclass

As part of the implementation of a new accounting system in fiscal year 1999-00, state officials determined that a sub-class designation would identify the program to which an expenditure should be charged. State officials did not require non-budgeted expenditure transactions to be identified to a subclass. The program designations in the Schedules of Total Expenditures & Transfers-Out are based on the sub-class designation used when the expenditures were recorded. The accounting system did not require agencies to code non-budgeted accounts with a subclass code identifying the expenditure program in which the activity occurred until September 2000. This new edit requires that all expenditure transactions entered through the general ledger include a subclass value. This non-budgeted activity is included in the column titled Program (Sub-Class) Not Specified on the Schedules of Total Expenditures & Transfers-Out.

Expenditures With R01 (Subclass)

During fiscal year 2001-02, there are two expenditure transactions recorded using a revenue subclass rather than an expenditure

Notes to the Financial Schedules

subclass. The two entries were accounting entity transfers and are shown on the fiscal year 2001-02 Schedule of Total Expenditures & Transfers-Out under the column title R01. Both transactions should have been charged to the Compliance, Valuation, and Resolution program.

4. Direct Entries to Fund Balance

Direct entries to fund balances in the General, Special Revenue, Debt Service, Capital Projects, Internal Service, Enterprise, Agency, Private-Purpose, and Permanent funds include entries generated by SABHRS to reflect the flow of resources within individual funds shared by separate agencies. Examples of these entries include transfers of the accommodations tax, employment security accounts, cigarette tax, treasure state endowment, public service commission, university millage, reclamation and development, alcohol funds, orphan share, renewable resource, and transfers to the General Fund.

5. Tax Assessments and Refunds

Certain natural resource and corporation tax assessments, totaling \$5.7 million at June 30, 2002, are not reported on the department's financial schedules because they are being protested administratively. Of the \$5.7 million, \$5.5 million are taxes reported in the General Fund. Collectibility of these tax assessments are dependent upon the decisions of the court, or other authorities, or agreed-upon settlements.

Certain corporations have requested refunds of approximately \$14 million that are not reported on the department's financial schedules, as of June 30, 2002. All of these refunds are for taxes reported in the General Fund.

6. Prior Year Activity

Coal Trust Investment Earnings

The majority of the \$12 million in prior year revenue and transfers-in on the Schedule of Changes in the Fund Balance and Property Held in Trust for fiscal year 2000-01 is made up of an adjustment for errors noted in the prior audit related to coal trust investment earnings.

Notes to the Financial Schedules

The majority of the Non-expendable Trust Fund prior year expenditures & transfers-out adjustments in fiscal year 2000-01 also relates to the adjustment of an error for coal trust investment earnings.

7. Nonbudgeted Activity

The majority of the nonbudgeted revenues & transfers-in and nonbudgeted expenditures & transfers-out in the Nonexpendable Trust fund in fiscal year 2000-01 and the Permanent Fund in fiscal year 2001-02 are related to coal tax transfers made in accordance with state law.

8. Agency Fund Changes

On the Schedules of Changes in Fund Balance for the fiscal years ended June 30, 2001 and June 30, 2002, Additions to Property Held in Trust is approximately \$26 million lower in fiscal year 2001-02 than in fiscal year 2000-01. The primary reason for the decrease is because of a change in how the department recorded collections for oil & gas production tax collections. In fiscal year 2000-01 the revenue that had not been distributed out to at fiscal year-end to other funds and counties was put into property held in trust. In fiscal year 2001-02, the undistributed revenue was recorded as a payable to other funds as required by state policy.



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Montana Department of
REVENUE

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Helena, Montana 59604-5805

December 4, 2002

Scott A. Seacat, Legislative Auditor
Legislative Audit Division
Room 160, State Capitol
P.O. Box 201705
Helena, MT 59620-1705

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LEGISLATIVE AUDIT DIV.

Dear Mr. Seacat:

We appreciate the opportunity to provide our response to the recommendations raised in the Financial Compliance Audit Report for the fiscal years ended June 30, 2001 and 2002. After a thorough review of the report we have the following comments.

Recommendation #1 – We recommend the department comply with the UI tax reporting requirement contained in its contract with DOLI.

Concur. We agree the department should meet the 15-day requirement for submitting the ETA 581 report. The department has resolved the issues with the data used for preparing the reports and anticipates the ETA 581 report for the December 31, 2002 quarter and all subsequent quarters will be provided within the 15 day time period.

Recommendation #2 – We recommend the department determine and record adjustments to properly reflect penalty and interest activity on the accounting records.

Concur. The department is continuing to analyze the revenue activity previously recorded in the unemployment insurance penalty and interest account and the unemployment insurance tax funds to determine the proper balances. Upon completion of the analysis, entries will be made to properly reflect the balances on POINTS and SABHRS. The department anticipates that appropriate corrections will be made by the end of calendar year 2002.

Recommendation #3 – We recommend the department:

A. Obtain timely reports that identify employers who have not fully paid UI or withholding taxes.

Concur. The department agrees that timely reports identifying employers who have not fully paid UI or withholding taxes is important. Subsequent to the audit report, the

department generated a report that identified delinquent filers for withholding taxes for the quarters ended September 2001, December 2001, March 2002 and June 2002, and for the fourth quarter of fiscal year 1999, and all subsequent quarters, for unemployment insurance. The department is working to generate these reports more timely.

B. Actively monitor and bill employers who have not fully paid wage base taxes due.

Concur. The department has assembled a team of individuals who will be working the existing out of balance unemployment insurance accounts to verify the validity of the employer account data. Where appropriate, the department will bill employers for amounts owing or refund amounts due the employer. Even though there will always be out of balance accounts that need to be worked, the department will make every effort to maintain the number of accounts at an appropriate level given the resources available.

C. Correct data errors, correct POINTS defects, and provide additional training to personnel.

Concur. The department will be working to correct data errors identified in the data quality report to be provided by IBM. The department will continue to address POINTS software defects. A POINTS training program has been developed and is currently being implemented. All POINTS users have completed, or will be required to complete, the first of two POINTS curriculum by the end of January, 2003.

D. Determine and record on the accounting records taxes owed to the department which have not been received.

Concur. As the items in "C" above are addressed, and accounts are reconciled, the accounting records showing taxes owed will be corrected as necessary.

Recommendation #4 – We recommend the department:

A. Accurately calculate UI rates as required by state law.

Concur. The department recognizes the importance of accurately calculating unemployment insurance tax rates for employers. For calendar year 2002, all penalty-rated employers were reviewed to determine if the rate was appropriate. As well, any rates protested by employers were analyzed and corrections were made when necessary. As data and programming corrections needed to accurately calculate experience ratings continue to be made, the accuracy of the rates for 2003 will be enhanced. Similar review steps as described for 2002 will also be employed in 2003 to ensure rates are accurate.

B. Establish controls over UI rate inquiries and adjustments.

Concur. The department agrees that sufficient controls need to be in place to monitor UI rate inquiries and adjustments. As noted in the auditor's report, the department increased the internal controls in 2002 beyond what was in place in 2001. A report is available to identify rates that have been changed and the department manages changes by limiting the number of people authorized to make changes to a very small number of employees. The department will also increase the 2002 internal controls to ensure there are adequate supervisory reviews for all UI rate inquiries and adjustments.

Recommendation #5 – We recommend the department establish management controls to ensure permanent travel advances are reasonable and necessary.

Concur. The department will reinstate a periodic review of all travel advances to ensure they are both reasonable and necessary.

The department currently has controls to record travel advances issued, along with the amount and date of the advances and reimbursements. The additional control will ensure that the proper employees have travel advances and that they are for a reasonable amount.

Controls have been in place to withhold travel advances from an employee's final paycheck upon termination. When payroll is processed, SABHRS is flagged to withhold the advance on terminated employees. The advance was not withheld from the final paycheck of the employee in question because the final check was a "free check" whereby deductions withheld over twenty-four pay periods are not withheld on free pay periods. We have since discovered that travel advances, both issued and recovered through the payroll system, can prevent this from happening when the pay period is a "free" pay period. Steps will be implemented on current and future travel advances to prevent such an occurrence in the future. The employee who left the department has since repaid the \$500 travel advance noted in the report.

The employee who received the two advances totaling \$4,000 has since repaid the advances and steps have been taken to ensure that will not occur again.

Recommendation #6 – We recommend the department take necessary action so the terms for payment from agency stores are the same terms as the state's payment to the vendors.

Partially Concur. The department is considering whether legislation should be introduced in the upcoming session to make the state's payment terms to vendors the same as the payment terms liquor stores have with the state. The impact to liquor stores needs to be fully considered.

Recommendation #7 – We recommend the department:

A. Comply with the state laws noted above.

Concur. The department agrees we should comply with state laws. Although we follow federal rules as they relate to the tax credit for research expenses and payments allowed for under MCA 15-31-150, the department will promulgate state rules as required by state law.

The department is required by state law to distribute from the coal severance tax bond fund any funds in excess of the amount required to meet all principal and interest payments on bonds payable from the fund. Due to an initial misidentification of funds received, the department distributed more funds than should have been. Consequently, the fund balance was below the required minimum balance for the two months identified. The department has since corrected the distribution, and has control procedures in place to prevent this from occurring in the future.

B. If necessary, seek legislation to amend the laws.

Concur. The department has worked with the Department of Administration and they will present legislation in the upcoming session to address the recommendation on timely deposits of fund. The department has developed and will present legislation to amend the notification required for change requests of unemployment insurance tax rates; conflicting statutes addressing extension requests of corporation tax returns; and monitoring extension requests of the elderly residential tax credit.

Recommendation #8 – We recommend the department:

A. Establish procedures to ensure counties submit collection reports in a timely manner as required by law.

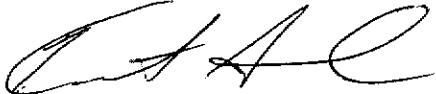
Concur. Although the department does not have complete control over how timely counties choose to file their reports, we agree procedures should be in place to encourage timely filing. Fiscal year 2002 was the first year the department was responsible for receiving the county collection reports. The procedures implemented by the department resulted in having all reports received at fiscal year-end, and all reports for the twelve months during fiscal year 2002 were received for all counties. Although state law allows the department to charge counties interest on money not remitted within 5 days of the monthly filing date, the department has not imposed interest. The department will continue to monitor the filings of the reports and consider charging interest if necessary.

B. Ensure accrual calculations are correct prior to recording them on the state's accounting system.

Concur. The department agrees accruals should be accurate when recorded on the state accounting system. In an effort to record the most accurate information for revenue reporting purposes the department delayed recording the accrual at fiscal year-end until all county collection reports had been received. Although the accrual was recorded by the fiscal year-end deadline, mistakes made when compiling the data received from the 56 counties prevented the accrual from being recorded accurately on SABHRS. The accounting records have since been adjusted to reflect actual revenues received. This was done during the normal process of reversing accruals and recording actual revenues received as prior year revenue.

We appreciate the professionalism demonstrated by your staff that participated in the audit, and thank you again for the opportunity to review the audit report and respond to the recommendations raised.

Sincerely,

A handwritten signature in black ink, appearing to read 'Kurt Alme', with a stylized, cursive script.

Kurt Alme
Director